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# An Outcome-Based Approach To a Rational Tax System, 2002

Maine State Planning Office

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# An Outcome-Based Approach To a Rational Tax System

Presentation of:  
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State Economist

To:

Speaker's Advisory Committee  
On Tax Reform

August 16, 2002

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## Acknowledgements

The concept of this presentation was originally suggested by Evan Richert, former Director of the Maine State Planning Office. All content, however, is the responsibility of the author.

# VISION

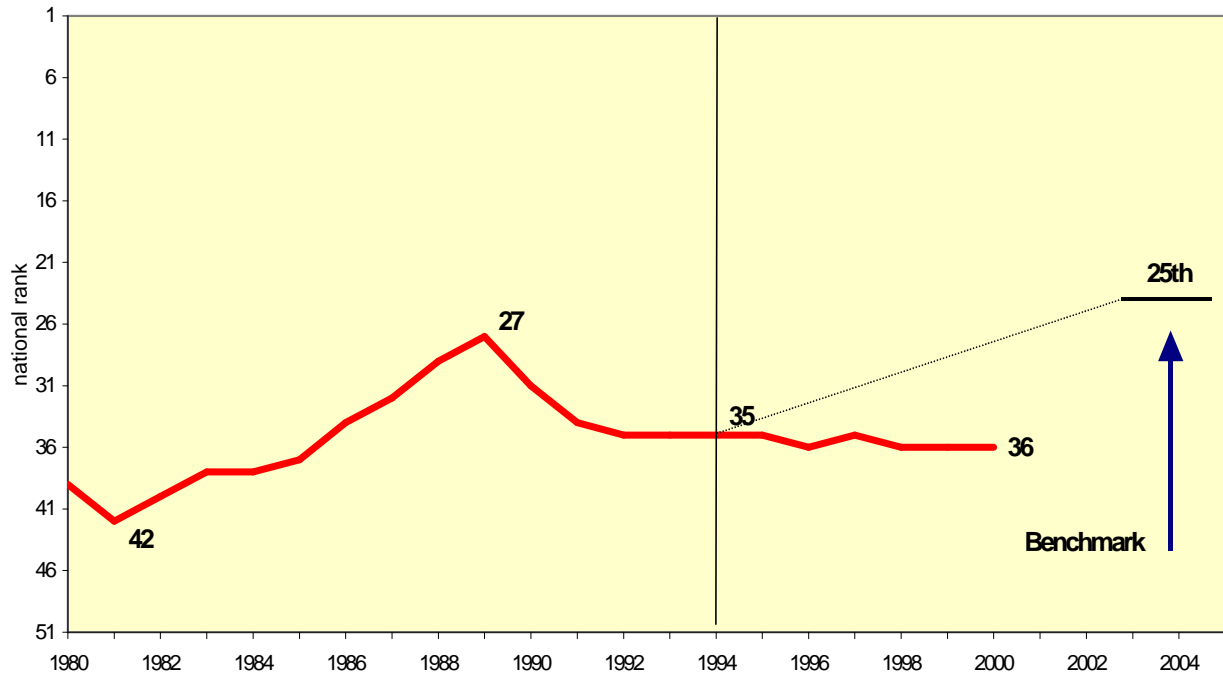
**A high quality of life for all Maine People**

**Measured, in part, by:**

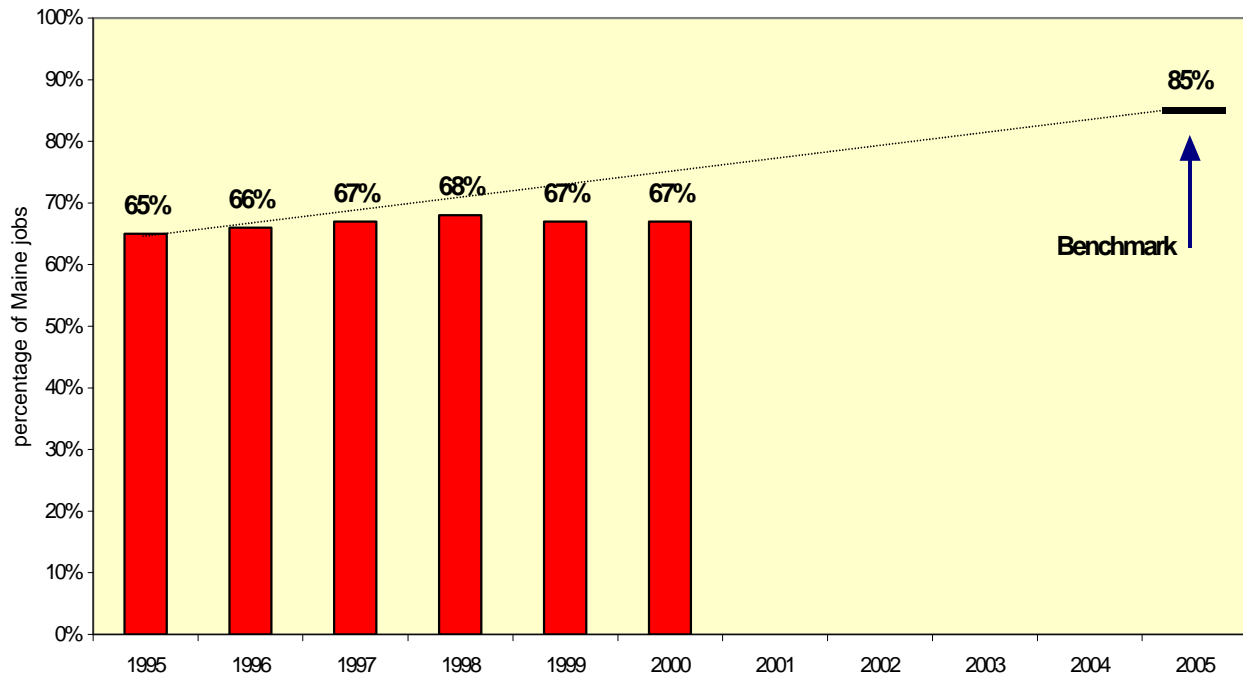
**Maine per capita income rank**

**Goal - 25th in nation**

## National Rank on Per Capita Income, 1980- 2000



## Percentage of Maine Jobs that Pay a Livable Wage, 1995-2000



# GOALS OF TAX REFORM

**Short term**: To put in place a series of expenditure cuts and, if necessary, tax increases that resolve the current structural gap and which, at a minimum, make the volatility of the current structure no worse and which preserve, to the fullest extent possible, the investment in the highest priority public goods and services

**Long term**: To create a tax structure that provides a stable stream of revenues that is both adequate for funding the sustained investment in high priority public goods and services and minimizes the distortion of economic investment in Maine

# PRINCIPLES OF TAXATION

1. **Burden**
  - Fiscal Discipline
  - Income
2. **Mix**
3. **Stability**
4. **Fairness**
5. **Competitiveness/Neutrality**
6. **Exportability**
7. **Efficiency**

**Principle:** Tax Burden

**Current Situation:** Among Highest in nation at 13.5%

**Why an issue:** Stifles investment in Maine

**Goal:** Reduce Maine's Tax Burden to the National Average (currently 10.5%)

**Choice of Actions:**

*NOTE: Not all of the "choices" presented in this document are recommended by the author. They are presented for discussion purposes, only.*

1. Reduce State and Local Government Spending

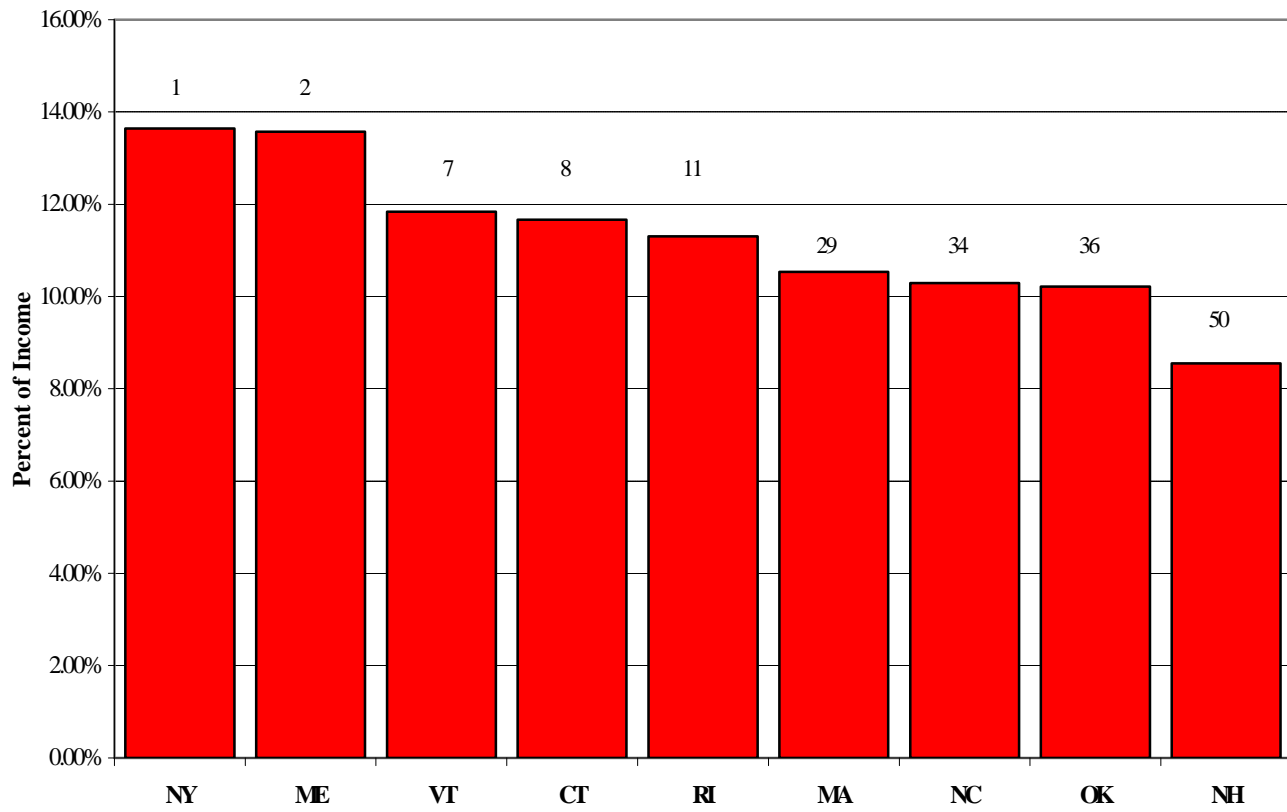
- Elimination of Programs/Services
- Direct Cuts
- Consolidation/Regionalization/Efficiencies
- Fiscal Discipline

2. Raise Income

- Invest in Education K-16 (emphasis post secondary)
- Invest in R&D
- Invest in Technology
- Encourage Investment in Productive Capacity



**State & Local Taxes as Percent of Personal Income in Fiscal 1999**



**Principle:** Tax Mix

**Current Situation:** Heavily dependent on Property Tax(32%) Income Taxes (31%), Sales Taxes (20%), other (17%)

**Why an Issue:** Property Tax Burden excruciating for some Maine residents, State nearing revolt

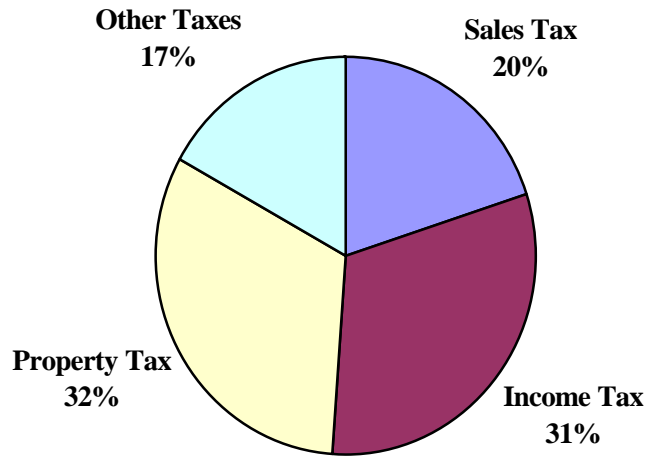
**Goal:** A broad mix of taxes – no single type of tax will account for more than 28% of all tax revenues raised at the State and local levels.

**Choice of Actions:**

In a revenue neutral scenario, reducing Property Taxes from 32% to 28% would cost approximately \$165 million and reducing Income Taxes from 31% to 28% would cost approximately \$125 million

- Broaden Sales Taxes to Consumer Services (excluding medical) +\$200 million
- Broaden Sales Taxes to Food (at 5%) + \$110 million
- Reinstate Snack Tax + \$16 million
- Broaden Sales Taxes to State & Municipal Entities +\$115 million
- Broaden Sales Taxes to Business Services +\$300 million
- Increase Sales Tax to 6% +\$140 to \$150 million

## Maine's 2001 Tax Mix



**Principle:** Stability

**Current Situation:**

- Highly Volatile Tax Structure
- State Tax Revenues grow/decline at as much as 3 times the rate of personal income
- Very narrow sales tax base (Full 1/3 derived from auto and building supply sales)
- Highly progressive Income Tax (Top 2% taxpayers 1/3 total or 10,000 people pay \$400 million)

**Why an issue:** Impedes wise investment and expenditure decisions by Government and destabilizes private investment environment

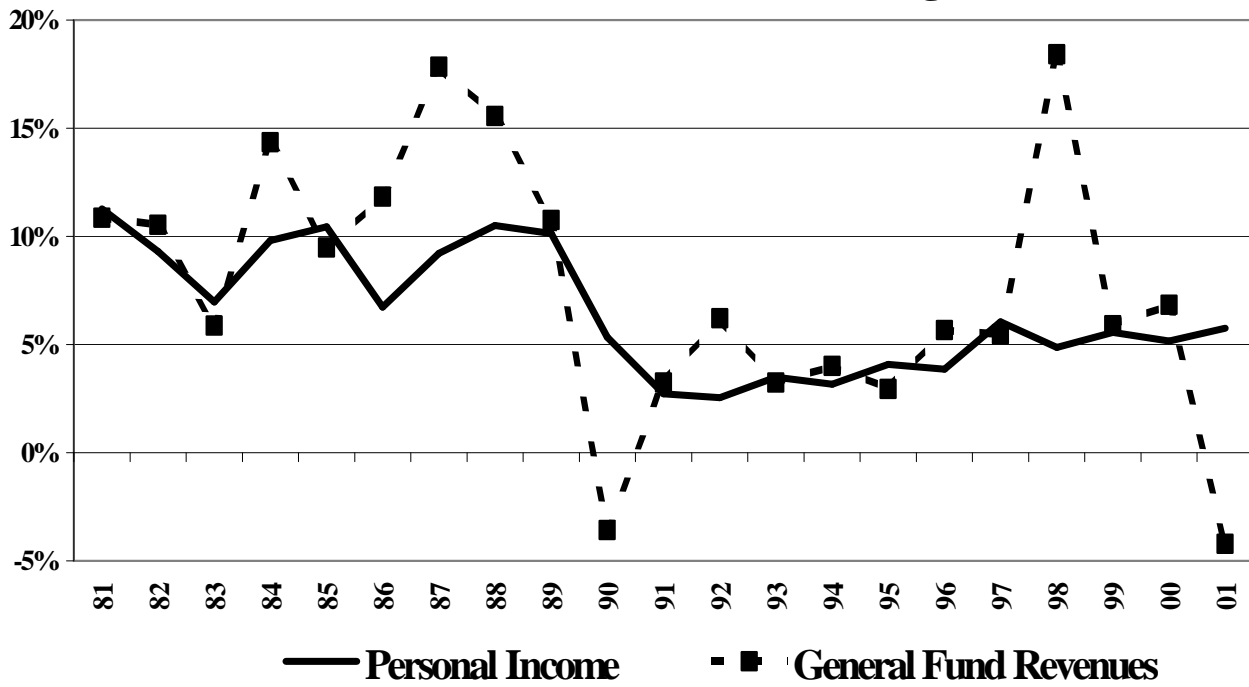
**GOAL:** The percent change in state and local tax revenues, separately and jointly, will not vary from the percent change in total personal income by more than 20% (measured as an average over a 2-year period).

**Choice of Actions:**

- 1) Reduce reliance on auto and building supply sales
  - Broaden sales tax base to include consumer and/or business services or food
  - Replace sales tax with a gross receipts tax
- 2) Reduce progressivity of income tax structure and, more specifically, reduce dependence on tax revenue derived from Capital gains
  - Reduce highest marginal tax rate, re-do and fully index brackets

# Maine Personal Income & General Fund Revenue

## Fiscal Year to Fiscal Year Percent Change



**Principle:** Fairness

**Current Situation:** Recognized nationally for fairness

**Why an issue:** Fairness is a deeply held value of Maine people

**GOAL:** No quintile (of median household income) will pay a larger percentage of income to state and local taxes than the next higher quintile.

**Choice of Actions:**

- Evaluate any proposed tax change by its adherence to the above stated outcome-based goal.

**Principle:** Competitiveness / Economic Neutrality

**Current Situation:** Maine's tax structure is not conducive to capital investment

- Very high top marginal income tax rate
- Most states either do not tax machinery and equipment, or tax at much lower levels

**Why an issue:** Maine's economic vitality, productivity and income are directly dependent on our ability to attract private investment.

**Goal:** Taxes that alter decisions about economic investments, particularly taxes on the creation of wealth, will be reduced to their lowest possible level, preferably to 0%.

**Choice of Actions:**

- Eliminate the personal property tax on machinery and equipment
- Reduce the highest marginal income tax rate
- Avoid the taxation of business services
- Create a stable investment climate  
(avoid tinkering with incentives)

**Principle:** Exportability

**Current Situation:** Given that Maine has the highest percentage of vacation homes and is a tourism state, it has not fully tapped non-residents.

**Why an issue:** Many tourists and non-resident home owners enjoy the natural beauty of Maine and utilize our infrastructure and services without fully contributing. Taxes raised from non-residents will directly reduce the burden on Maine residents.

**Choice of actions:**

- Increase meals and lodging tax (each percentage point adds \$20 million, 30% of which is borne by non-residents).
- Broaden sales tax base to include amusement and recreational services (+ \$30 million)
- Seek a constitutional change to charge a higher rate on 2<sup>nd</sup> homes (offset with higher homestead exemption if Maine residents).



**Principle:** Efficiency

**Current Situation:** Maine's administrative costs of levying and collecting taxes are very reasonable.

**Goal:** The cost of collecting taxes will not exceed 1% of the revenues generated

**Choice of Actions:**

- Avoid tax changes that significantly add to administrative burden and costs.